

HOUSE FINANCE COMMITTEE
FIRST SPECIAL SESSION
June 8, 2021
1:34 p.m.

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CALL TO ORDER

Co-Chair Merrick called the House Finance Committee meeting to order at 1:34 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Kelly Merrick, Co-Chair
Representative Dan Ortiz, Vice-Chair (via teleconference)
Representative Ben Carpenter
Representative Bryce Edgmon
Representative DeLena Johnson (via teleconference)
Representative Andy Josephson (via teleconference)
Representative Sara Rasmussen (via teleconference)
Representative Adam Wool (via teleconference)

MEMBERS ABSENT

Representative Bart LeBon
Representative Steve Thompson

ALSO PRESENT

Neil Steininger, Director, Office of Management and Budget, Office of the Governor; Lucinda Mahoney, Commissioner, Department of Revenue; Alexei Painter, Director, Legislative Finance Division; Representative Mike Cronk.

SUMMARY

PRESENTATION: FY 22 10-YEAR PLAN OFFICE OF MANAGEMENT AND BUDGET

PRESENTATION: ANALYSIS OF GOVERNOR'S FISCAL PLAN BY LEGISLATIVE FINANCE DIVISION

Co-Chair Merrick reviewed the meeting agenda. She recognized Representative Mike Cronk in the audience.

^PRESENTATION: FY 22 10-YEAR PLAN OFFICE OF MANAGEMENT AND BUDGET

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NEIL STEININGER, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, OFFICE OF THE GOVERNOR, provided a PowerPoint presentation titled "State of Alaska, Office of Management and Budget, House Finance Committee: FY2022 10 Year Plan," dated June 8, 2021 (copy on file). The plan had been updated to include the governor's proposed constitutional amendments. He began on slide 2 and discussed the governor's 10-year plan. He explained that statute required the governor to submit an annual 10-year plan in conjunction with the December 15 budget. He detailed that the plan had to balance sources and uses of funds. He elaborated that over the 10-year projection period, the proposed expenditures had to match or be supported by projected revenues or available savings.

Mr. Steininger stated that the plan was a projection of the impacts of policy decisions related to revenues and expenditures. The plan assumed the enactment of any of the governor's proposed fiscal policy objectives included in the December 15 budget (including budget amendments, supplemental requests, and significant legislation with fiscal impacts released on December 15). The plan was also reflective of future goals and targets associated with spending, new revenues, or changes over the 10-year period. He highlighted that the 10-year plan was a statement of policy and a statement of a long-term fiscal plan by the executive branch and governor. He noted the plan was not intended to be a baseline model or projection of future events based on no action.

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Co-Chair Merrick noted that Representative Rasmussen joined the meeting via teleconference.

Mr. Steininger turned to slide 3 and discussed the 10-year plan updated for the governor's proposed HJR 7 and SJR 6. He explained that typically the 10-year plan was released with the budget on December 15; it was not typically revised during the session that followed. However, the administration was considering major changes to the state's

fiscal structure through HJR 7/SJR 6; therefore, the need for updating the long-term fiscal outlook was imperative. The updated plan included all of the governor's supplemental requests except for \$1.2 billion for a supplemental Permanent Fund Dividend (PFD). The request continued to be active, but the administration acknowledged a supplemental PFD payment may not be part of the structural plan.

Mr. Steininger continued to review slide 3. The updated 10-year plan included all of the governor's amendments, including amendments released the previous week covering bargaining unit adjustments. He elaborated that the plan reflected a 50/50 dividend split, which aligned with the governor's proposed constitutional amendment, but not the administration's budget released on December 15. He stated that without the 50/50 structural change, the projections would revert back to using the statutory PFD. He relayed that the plan excluded the Alaska Housing Finance Corporation (AHFC) bonding for the capital budget. He informed members it would appear as an increase in capital spending for undesignated general funds (UGF). He explained that the administration continued to support the proposal; however, it had not passed during regular session and was no longer reflected in the plan modeling.

Mr. Steininger relayed that the updated plan included savings from SB 55, which passed during regular session and impacted the way Public Employees' Retirement System (PERS) payments were paid. The plan had been updated to include a \$3 billion transfer from the Earnings Reserve Account (ERA) to the Constitutional Budget Reserve (CBR). He explained that the amount would act as a bridge fund to allow the state to make it through the next couple of years while the changes in revenue and expenditures became visible and brought the plan into balance over the long-term. Additionally, the plan reflected the rolling of the Power Cost Equalization (PCE) Fund into the Permanent Fund in FY 23 and the impact to the General Fund budget from moving PCE program and community assistance program to UGF in FY 24 going forward.

Co-Chair Merrick noted she would ask members if they had questions at the end of each slide in order to make it easier for members online.

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Mr. Steininger turned to slide 4 titled "10 Year Plan - Short Term." He explained that the assumptions in the plan fell into two categories: short-term assumptions including FY 23 and FY 24 where assumptions could be more nuanced and long-term assumptions including outyears that contained less visibility in terms of impacts policy decisions would have. The plan included an FY 23 and FY 24 phase out of the one-time and short-term federal relief from FY 21 and FY 22. He explained there were some expenditure increases in the future resulting from the phase out. The plan had a baseline capital budget of \$150 million. He detailed that the capital budget was fairly constrained and allowed for major match programs and a small amount of discretionary capital. The capital budget began escalating at a 1.5 percent rate beginning in FY 23 to acknowledge costs would increase over time.

Mr. Steininger continued to address the short-term portion of the 10-year plan. The plan included two years of budget reduction targets of \$100 million per year. The plan set a target for budget reductions as part of the annual budget development process. He highlighted the existing gap between expenditures and revenue. He stated the solution [to fill the gap] needed to come from all sides of the equation. He remarked that targets would involve policy discussions and may include some statutory changes. He referenced SB 55 that addressed cost drivers in the budget. The \$100 million per year included positive and negative cost drivers in the state budget such as formula programs where a population or demographic change could impact the cost of the program. He referenced other areas that should be impacted positively by positive market returns such as retirement contributions by the state.

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Representative Edgmon stated that looking out 10 years reminded him of the National Weather Service where there was some sense, but it was difficult to predict what would happen. He had the impression that in order to look 10 years out with the governor's 50/50 plan, there were many assumptions built in that the current presentation did not reflect. He highlighted the necessary statutory changes to get to \$100 million in cuts per year as an example. He assumed the proposal referred to UGF. He considered a population inflation adjusted with the late 70s, if the

population in Alaska grew, he would like to see more definitively where the cuts would come from. He understood the administration had indicated more information was forthcoming in terms of budget cuts and revenue sources. He underscored that the governor's 50/50 plan engendered much more detail. He referenced the targeted cuts [listed on slide 4] and questioned whether the reduction could be made without shutting down schools in rural Alaska or cutting Medicaid when hopefully the population and needs were increasing. Under the scenario, new revenue would be necessary. He recalled that in 2008 former Representative Mike Hawker's bill had created the 10-year forecast. He believed there was utility to the forecast; however, under the current circumstances he believed there were limitations to what the plan could provide.

Mr. Steininger agreed there was uncertainty when looking out 10 years in the future. He explained it was the reason the presentation was broken out into a short-term and long-term outlook. He stated it was reasonable to set targets for reductions in FY 23 and FY 24 to bring expenditures down. He elaborated on the importance of a clear goal when working with departments and agencies. He agreed that setting goals for FY 27 was not necessarily reasonable at the current time. The idea was to set short-term goals and look at what the long-term impact would be if the goals were achieved. He remarked that most other forecasted timelines were in the five to six year horizon. He cited the capital improvement six-year plan and fiscal notes that were projected six years out. He noted that the annual \$100 million reductions were only for the first two years of the plan. The administration did not expect significant reductions year-over-year for the entire projected period.

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Vice-Chair Ortiz asked if it was safe to assume that with an FY 23 reduction goal of \$100 million, the reduction would have to come from the two large cost drivers including health and human services and education.

Mr. Steininger replied, "Not necessarily." He stated the cuts did not have to come from the areas mentioned by Vice-Chair Ortiz, but they would need to be part of the conversation. He stated decisions for how to fund the particular programs needed to be based in policy. He referenced the last bullet point on slide 4 specifying that

the plan would require policy discussions on major budget drivers. He elaborated that policy discussions should be centered around how to achieve program goals at a lower cost. He stated it was difficult to provide a specific example because the discussions for FY 23 were in the beginning stages. He relayed that apart from the large budget areas, the administration was looking at other expenditures that may bring smaller savings. He remarked that the reductions would not be limited to education and health and social services.

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Vice-Chair Ortiz stated that he had assumed the cuts would have to come from the Department of Health and Social Services and Department of Education and Early Development because other agencies had been cut an average of 25 percent in the past several years. He remarked that when looking at the budget spending graph, the other agencies did not account for very much of the \$4.3 billion to \$4.5 billion budget.

Vice-Chair Ortiz looked at the baseline capital budget of \$150 million on slide 4. He asked if Mr. Steininger thought the proposal was good policy in relationship to the ever increasing deferred maintenance obligation.

Mr. Steininger replied that a \$150 million capital budget was fairly constrained. He detailed that the proposal would allow for the major match programs, significant recurring annual capital items, and a small amount of discretionary capital. He elaborated that the deferred maintenance funding typically showed up as designated general fund (DGF) via the Alaska Capital Income Fund and was not necessarily part of the \$150 million. He explained that Alaska Capital Income funding was not projected to grow significantly in the outyears; therefore, it would be necessary to look into finding a way to supplement the funding source with discretionary capital or another source.

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Co-Chair Merrick referenced Mr. Steininger's statement the administration was having internal discussions about some of the major cost drivers. She asked if the policies would be ready to present in the August special session.

Mr. Steininger answered that he could not say for certain. He stated that due to the annual budget cycle, most of the administration's conversations tended to revolve around the December 15 release deadline. He relayed that if any ideas were ready for legislative consideration, the administration would discuss the topic internally.

Representative Wool recalled a presentation from an outside consultant to the committee about one year earlier pertaining to Medicaid cost. He recalled being told the costs of medical care in Alaska were increasing faster than inflation. He remarked that Alaska's costs were increasing faster than costs in any other state. The presentation had pointed to a Medicaid crisis where costs would be increasing at a high rate. Additionally, the state's population was aging, which required more healthcare. The combination resulted in a bleak outlook in terms of Medicaid expenses. He referenced the administration's proposal to cut the major cost drivers. He wondered how the \$100 million cuts would integrate with rising costs. He noted that the Base Student Allocation (BSA) formula had not been increased in numerous years. He highlighted that the university's budget had been cut and the cost of corrections was increasing due to policy change. He asked how to reconcile the issues with the proposal to cut \$200 million in the upcoming years.

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Mr. Steininger responded that one of the constant struggles associated with constraining the budget was natural upward pressures on costs. He informed members that the DHSS team working on Medicaid was aware of the need to find ways to accommodate natural cost increases before making any substantive change to reduce the overall system cost. There were areas DHSS was looking to determine how to make policy changes or work with the federal government on change that would result in a reduction in the state's cost for the Medicaid program. He clarified the administration was not claiming the \$200 million reduction over a two-year period would be an easy process. He highlighted upward cost drivers impacting the way the state did business across all agencies. He stated policy discussions would have to take place around every aspect of the plan.

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Mr. Steininger turned to slide 5 focusing on the long-term portion of the 10-year plan (FY 25 through FY 30). He highlighted an operating and capital budget growth projection of 1.5 percent per year, which was lower than inflation estimates of 2 percent per year by Callan. The plan used the lower number because when looking at state budget history, state expenditures tracked better with availability of revenue versus inflation. He pointed to a graph on the slide reflecting Alaska revenue and spending history from 1985 to 2020. He highlighted a black line showing the FY 85 budget adjusted for inflation. He explained that while inflation had steadily increased, the budget had stayed in line with revenues.

Mr. Steininger pointed out that during constrained revenue from 1986 to 2004, the budget had stayed relatively flat with some variability. He explained that the state was facing another 10 years of fairly constrained revenues. He stated it was fairly safe to assume policy choices made during the time period would be informed by the constrained revenue. The administration did not believe future administrations or legislatures would inflate spending beyond available revenue. He speculated that operating budget growth of 1.5 percent per year was likely optimistically high during a period of fairly flat revenue.

Mr. Steininger stated that other assumptions in the long-term plan tied to official forecasts and current policy. The assumptions followed official forecasts for debt, PERS state assistance payments, and oil and gas tax credits. The plan also included current policy assumptions such as 50 percent funding of school bond debt and Regional Educational Attendance Area (REAA) schools proposed in the governor's FY 22 budget (and what had been enacted in FY 20).

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Representative Edgmon asked if the red line reflecting the budget [on slide 5] had been adjusted for population.

Mr. Steininger clarified that the number reflected the nominal values without inflation or population adjustment. The black line showed FY 85 budget adjusted for inflation. He clarified that the black line would be steeper and higher when adjusted for population.

Representative Edgmon asked for verification that Alaska was one of two states without a broad-based tax.

Mr. Steininger replied that he believed so.

Representative Edgmon stated that without a broad-based tax, the more people using the roads, schools, correctional system, did not bring any additional revenue. He believed the plan anticipated additional revenue. He highlighted that funding school bond debt and REAA schools at 50 percent was a transfer of responsibility to local municipalities. He elaborated that the action would result in cuts at the local level or new revenue sources at the local level. There were downstream impacts of the 50/50 plan that should be included in the larger story told about the proposal. He was a skeptic of the governor's 50/50 plan because he saw too many things in the future that may or may not exist that were not considered. He referenced the earthquake from 2018, a heavy fire season, a substantial dip in the market as in 2008/2009, or other event that could tie the hands of future legislators.

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Mr. Steininger responded specifically to Representative Edgmon's concern about a major disaster such as an earthquake that would require an immediate draw on the state treasury. He stated that while the model did not include the potential for unpredictable events like disasters, they were considered in the philosophy put forward by the administration. He stated that a key purpose of the \$3 billion bridge fund concept ensured a minimum balance of approximately \$1.5 billion in the CBR during the 10-year timeframe. He relayed that \$500 million was needed for daily cashflow in the CBR; funds above that amount could be used to address revenue volatility or immediate needs such as disaster funds. The funds were not reflected in the expenditure line, but they were reflected in the savings line.

Representative Edgmon continued to struggle with looking at locking something into the constitution that would be iron clad while hoping to grow the state, increase prosperity, improve the balance of revenues and expenditures, and provide quality services. He supported downsizing government and limiting taxes. He would like to not do a

broad-based tax. He looked at a bullet on slide 6 that specified \$300 million in revenues or further reductions beginning in FY 25 going forward. He stated it may be the right thing to do, but it may not be the right thing if population grew by 100,000 and schools were bursting at the seams. He would continue to be a skeptic until proven otherwise.

Representative Carpenter asked if there had been a broad-based tax between FY 85 and FY 05.

Mr. Steininger replied in the negative. He did not recall the exact year the income tax had been repealed.

Representative Carpenter asked if the state had essentially split the Permanent Fund earnings 50/50 between state services and PFDs (between FY 85 and FY 05).

Mr. Steininger responded that between FY 85 and FY 05, the earnings of the Permanent Fund had been deposited into the ERA and the fund corpus. He clarified that the funds had not been spent on anything but PFDs.

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Representative Carpenter stated he had been under the impression the statutory formula had been 50/50 between services and the PFD.

Mr. Steininger answered that while the state may have been allowed to expend Permanent Fund earnings, it had not done so other than to cover management and legal costs related to the fund.

Representative Carpenter understood there was a lot of speculation with a 10-year plan. He looked at the graph on slide 5 and observed that the state had been able to maintain a fairly flat revenue and budget trajectory over the 20-year period [between FY 85 and FY 05]. He highlighted the large spike in revenue and spending around FY 05. He asked what had held the budget flat and affordable during the aforementioned time period.

Mr. Steininger replied that the budget decisions made during the time period had been made during constrained revenue. He explained there had not been revenue available to allow for increases to the budget. He relayed that

spending had increased when revenue increased. The point of slide 5 was to demonstrate that the pressure of inflation did not necessarily drive the spending increase. He explained that the inflationary change between FY 05 and FY 08 was not at the level of the slope shown in red.

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Representative Carpenter asked how to compare the current size of the economy to the economy between FY 85 and FY 05. He was interested in the size of the economic engine necessary to sustain the size of government. He noted the legislature had been able to avoid spending more than incoming revenue for two decades. He understood that the lack of money had restrained spending. He observed that it had not been the case between FY 16 and FY 20. He stated that the argument in a long-term plan would be to raise taxes. He reiterated his question and asked if it was feasible to add a tax burden to the economy at its current size. He looked the green line as a measure of the size of economic output to state government and observed that it was fairly in line with what it had been for two decades prior to the large spike due to high oil prices.

Mr. Steininger could follow up with information on the Alaska GDP [gross domestic product] over the specific timeframe compared to the present. He stated that spending needed to be in line with available revenue. He detailed that another component was setting policy to prevent spending increases should revenue increase again. He looked at the red line [reflecting the budget] on slide 5 and noted it had been flat during the 1980s and 1990s and had not dropped down to meet revenues in recent years (spending had dropped somewhat, but there continued to be a gap between spending and revenues). He remarked that it was much easier to add programs than to remove programs. He stated that preventing the scope increase was fundamental to discussions about the long-term sustainability of the state's fiscal picture. He highlighted the importance of ensuring increases were driven by demand and not merely by availability of cash.

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Representative Carpenter asked the commissioner of Department of Revenue to respond to the question as well.

LUCINDA MAHONEY, COMMISSIONER, DEPARTMENT OF REVENUE, shared that while the price of oil had been very high, the legislature and governor had increased education funding from 50 percent to 80 percent, which may have accounted for some of the increase in the years in question. Additionally, the state had picked up a higher portion of retirement costs above the 22 percent. She stated that the revenues had enabled the state to help communities more.

Representative Carpenter stated that the information was helpful in explaining why the red line [reflecting the budget on slide 5] grew. He clarified his question. He explained there had been no broad-based tax between FY 85 and FY 05, yet the state had been able to maintain a flat budget for two decades. He remarked there was a budget gap at present and the CBR had been drained. He looked at the chart and pointed out that current incoming revenues were similar to revenues brought in between FY 85 and FY 05. He noted he would be interested to see the data adjusted for inflation. He remarked that the green line was reflective of what the state had taken out of the private sector economy to pay for state government. He asked if the current size of the economy was greater than it had been for the two aforementioned decades. He wondered if there was room for a broad-based tax based on the size of the state's economy. Alternatively, he asked if consideration should be given to bringing the budget line down to align with the revenue line.

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Commissioner Mahoney agreed there were currently expenditures that exceeded what the state could afford. She detailed that the state had made decisions to continually support its communities, schools, education, and health in an unaffordable way. She addressed the question about whether the economy could afford it. She stated it was a significant policy question currently under discussion. She did not have the answer. She elaborated economists could run models and consider the macroeconomic impact of a sales or income tax and determine how it would impact the different sectors of the economy. Other questions included how a tax would impact the state's population and businesses. She relayed that no one had a precise answer to the question.

Representative Carpenter remarked that there was a conversation trying to solve a political problem of what to do with the PFD, taxes, cuts, and more. He thought it was important to ask whether the state's economy could support additional revenue before taking any action with regard to additional revenue. He wondered if the economy could afford additional taxes. He looked at historical information and observed that the state had done fine without a broad-based tax. He emphasized that the state was coming down from a binge off of a period of high revenue. He stressed that the previous economy no longer existed. He wondered whether the current economy looked more like the period between FY 85 and FY 05 or FY 05 to FY 13 in terms of what it could sustain in additional revenue. He asked the administration to help the legislature understand how much money could be pulled out of the economy without doing damage. He was hearing comments about the need to implement tax and raise revenue. He underscored there had been something that had allowed the state to survive between FY 85 and FY 05 that did not include a broad-based tax.

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Co-Chair Merrick asked for verification that the red budget line on slide 5 included the PFD.

Mr. Steininger replied, "No, it does not."

Co-Chair Merrick believed it was worth noting.

Representative Josephson referred to slide 5 regarding the funding of school bond debt and REAA schools at 50 percent. He noted that Mr. Steininger had stated it was current policy. He clarified it was the administration's current policy. He noted that when the oil recession began, former Senator Anna MacKinnon had sponsored a bill in the 2015 session to put a moratorium on the state's contribution to new expenditures. He wondered if the law was no longer in effect due to a sunset clause. Additionally, he asked whether the state was currently contributing to new construction.

Mr. Steininger responded that the sunset had been extended. He did not recall the extended sunset date on the law.

Representative Josephson stressed that it meant the situation in terms of impact on local government was even

worse. He explained there was growing need and less expenditure by the state. He understood that if the state became flush with cash again, there was wisdom in not spending everything it had. He highlighted that the chart reflected the state had not spent all of the incoming revenue in the past, which was the reason there had been \$17 billion in savings outside the Permanent Fund at one point. He pointed out that part of the reason for the expenditures was due to the enormous need and a backlog of demand. He underscored that Alaska led the nation in sexual assault crimes. He added there were 2,300 contaminated sites that needed cleaning. He relayed that the studies Representative Carpenter wanted to see had already been completed by in the [House] Ways and Means Committee. The studies showed the impact of new revenue measures on the economy. He encouraged members to review the information.

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Representative Wool remarked that the graph [on slide 5] was adjusted for population and inflation. He believed that when factoring in population growth and inflation, the state's budget was lower than it had been for many decades. He stated that the level of revenue shown in red was not reflective of the economy and only showed the amount of revenue the state was receiving, predominantly from oil taxes and income. He highlighted that the state's GDP was not on the graph. He stressed that GDP in 1985 had primarily been from oil and gas; however, over the past several decades GDP had expanded well beyond oil and gas. He suggested that the health of the economy was about the GDP and many sectors had grown greatly, including tourism, finance, transportation, and other. He pointed out that the information was not included on the slide because the state was not receiving any revenue from the additional sectors.

Representative Wool stated that if the state's population increased, i.e., when there had been an effort to get Amazon to come to Anchorage with 20,000 employees, it would have taxed the state's economy instead of helping; however, GDP would have increased. He stressed that the graph was lacking in data, and it was hard to draw any valuable conclusions from it. He underscored that other sectors apart from the oil and gas industry currently accounted for over half of the state's GDP. He thought determining the state's economy could not sustain revenue based on the information in the graph was a misnomer. He believed more

data was needed in addition to oil and gas revenue when looking at the health of the overall Alaskan economy. He spoke to the desire for increasing the economy and population. He remarked that when the pipeline first yielded money in the 1970s there had been an increase in state spending because there had been a lack of state spending for some time. He believed it was a similar situation to the timeframe shown on the graph. He thought catchup was needed.

Co-Chair Merrick clarified that the green line reflected revenue and the red line reflected the budget.

Commissioner Mahoney informed the committee that in 2004, the state's GDP had been \$43 billion. The current GDP was \$53 billion. The composition of the GDP was currently much more diverse than it had been in 2004. She stated that oil and gas was no longer the primary source of GDP.

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Representative Carpenter clarified that he had not claimed the state could not afford a broad-based tax. He had asked if the state could afford a broad-based tax. He noted that for two decades the state's spending had been flat without a broad-based tax. He remarked it was not necessarily the case that a broad-based tax was needed to balance the budget.

Representative Edgmon estimated that the state's population had come close to doubling during the period reflected on the graph starting in 1984/1985. He explained that without a broad-based tax and with population increase, there were more people using services that fell on the agencies and legislature, primarily funded by oil revenue in the past. He thought it would be fascinating to do an analysis at the point when there had been an uptick in the revenue and budget lines [shown on slide 5]. He recalled being on the House Finance Committee in the past when the committee had increased state troopers significantly because there had been the money to do so. He remarked that years prior to that, the state had not had the money.

Representative Edgmon pointed out that the graph only reflected state spending and did not include federal spending. He highlighted that from 1983 through 2006, Alaska had the late Senator Ted Stevens bringing in a

substantial amount of federal money into the state. He pointed to the budget and revenue spike between FY 06 to FY 12 and remarked that there had been record capital budgets at the time. He indicated that the decline in the budget line was largely due to smaller capital budgets. He stressed that Alaska still had a tremendous number of needs. He remarked that when the legislature hopefully had the opportunity to appropriate money through the federal infrastructure bill, there were substantial deferred maintenance and construction needs. He listed the need for construction of buildings, schools, roads, bridges, and other.

Representative Edgmon reported that the cost of energy in Alaska had gone up tremendously when revenue and the budget increased. He shared that the price of gas per gallon in Dillingham had increased fivefold or more. Additionally, the cost of operating the Alaska Marine Highway System (AMHS) and heating state buildings had increased substantially. He would struggle with putting iron clad parameters in the constitution, knowing the volatility in the highest cost state because there would be a lot of give and take in the future to make everything work. He noted that the current unmet needs included operating and capital expenditures. He stressed that the conversation and information needed to go much deeper for the proposal to make sense.

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Co-Chair Merrick agreed with the capital budget comments made by Representative Edgmon.

Mr. Steininger moved to revenue assumptions in the 10-year plan on slide 6. Traditional revenues were per the Department of Revenue (DOR) 2021 spring forecast. He relayed that POMV revenues had been updated by DOR based on internal modeling using actual FY 21 returns through April 26, 2021. He explained that returns to the Permanent Fund had been much greater than anticipated in the past year, which resulted in a significant change in the previous POMV revenue projection. He noted that the projections would revert to the 6.25 percent return estimate for FY 22 going forward. The plan included \$150 million in new revenue for FY 24 and \$300 million beginning in FY 25 going forward. He acknowledged that new revenues would take time to turn on. He remarked that if the state was able to exceed the

governor's reduction targets of \$100 million per year for two years, the need for new revenue may be somewhat alleviated.

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Mr. Steininger moved to a table on slide 7 showing the governor's amended budget 10-year plan with HJR 7 and SJR 6. The top portion of the table included UGF revenue. He remarked that UGF revenue built to the state's annual deficit or surplus. The section included traditional UGF revenue, the POMV draw for government, and new revenues. He pointed to FY 22 showing the impact of HJR 7 and the 50/50 PFD. He elaborated that the \$1.5 billion shown under the POMV draw for government line reflected 50 percent of the 5 percent POMV draw [from the ERA].

Mr. Steininger moved to the middle section of the table, which included UGF expenditures including agency operations, statewide items, and the capital budget. He noted that the [governor's proposed] \$100 million per year reduction was reflected in the agency operations line; however, it was not necessarily where the reduction would be implemented. He remarked that the administration would reduce costs in the statewide items if possible. He noted the reduction merely needed a place on the chart. The section also included the total General Fund appropriations, the pre-draw surplus or deficit, and the savings draw. He pointed out that the savings draw was only made possible by moving the bridge fund into the CBR. He looked at FY 22 under the reserve balances section of the table and highlighted a net increase in the CBR of \$1.6 billion (net of the deficit draw from the CBR and the bridge draw from the ERA into the CBR). He remarked that the bridge draw enabled the state to work through five years of the model showing declining deficits over time to reach the period in FY 27 where surpluses began. The bridge fund also enabled the state to maintain a CBR balance of greater than \$1.2 billion to allow for flexibility related to unpredictable events (e.g., earthquakes or large fire years).

Mr. Steininger moved to the bottom section of the table on slide 7 showing the Permanent Fund balance growing to \$90 billion in FY 30. He noted that the \$76.4 billion was based on DOR's most recent update for the POMV draw. He believed the fund balance was currently higher due to the

continuation of positive returns. The bottom line of the section showed the PFD on a per capita basis. He highlighted that the draw from the ERA in FY 22 was roughly \$6 billion returning to the POMV draw only in subsequent years. He understood there was some confusion about how the PFD payment in FY 22 was proposed to be made. He stated that the payment would come out of the draw into the CBR. The governor's proposal included constitutionally protecting the POMV draw and the Permanent Fund starting in 2024 after ratification by the voters.

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Representative Edgmon asked if the administration had modeled what it would take to not have any new revenues. For example, he asked if the administration had looked at a 75/25 percent split (government services/PFD), which he estimated would result in a PFD around the historical level of \$1,000 to \$1,100.

Mr. Steininger replied there was a policy discussion about the split. He stated that the administration believed the 50 percent split was an equitable distribution to the people of Alaska. He relayed that it was less about making the math work and more about sharing the resource with the people. He looked that the governor's 10-year plan and stated that the math worked with the combination of projected POMV revenues, traditional revenues, and fairly modest increase in new revenues.

Representative Edgmon referenced Mr. Steininger's statement about equitability for Alaskans. He asked whether the administration had talked to Alaskans about the subject. He shared that he had taken part in numerous public hearings in 2019 where he had heard directly in Kenai, Anchorage, Fairbanks, Bethel, Sitka, Ketchikan, and maybe a little less in Mat-Su, that the public wanted a balance of everything including a sustainable PFD and public services. He presumed the new revenues referenced in the 10-year plan were a combination of sales tax and taxing the oil industry. He thought income tax appeared to be "way off the table" in terms of political palatability. He reasoned that the \$300 million would come from sales tax in an environment where many smaller communities such as Cordova, Dillingham, Nome, Sitka, and Ketchikan already had maximum levels of local sales tax. He pointed out that some of the revenue would have to come from industry somewhere. He

elaborated that the funds would not come from the fishing industry. He mentioned the mining industry and potentially a seasonal tax from tourism. He surmised that the majority of the funds would have to come from the oil industry, unless there was a sales tax, which would also impact the economy. He asked what the projections were for the \$300 million. He thought the administration could present the information to the legislature by August. He believed the information should arguably be ready to present to the legislature presently because the administration's original timeline had been to get everything approved by June 18. He asked where the \$300 million would come from.

Commissioner Mahoney answered that the governor's goal for the first session was to first put the structure in place. The governor wanted the legislature to work on putting the 5 percent draw and 50/50 plan in place. She elaborated that the governor recognized new revenue measures would be needed, which would primarily be on the governor's call for the August special session. She stated that things had been delayed and some of the topics would carry over into the second session. She stated that the administration would discuss new revenue measures in the second session. She informed committee members that the administration was working on specific revenue measures currently. The revenue measures were very different than any tax seen in Alaska and were more modern. She noted that the administration was still flushing the measures out. She stated that the administration would need to work with the Department of Law to ensure the measures fell within the state's constitution, to make certain the taxes could be implemented. She added that the administration needed to work with the legislature on the ideas.

Commissioner Mahoney remarked that the governor had stated repeatedly that he wanted the August conversation to be collaborative to identify the new measures. She noted that the administration was currently working with a consultant on revenue estimates associated with the gaming industry. She remarked on the importance of the economic impacts of the industry on the state's economy and the potential to diversify the economy. She stated a few more revenue measures would be brought to the legislature.

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Representative Edgmon asked why the administration was not considering a 75/25 percent split where the average Alaskan received a historical level PFD and did not get taxed for it. He stated that the split would allow the state to maintain services and hopefully afford a capital budget exceeding \$150 million. He wondered why they would not take an approach where new revenues were unnecessary and where Alaska could continue to be the only state without a broad-based tax. He noted Alaska was also the only state that would be funded by an endowment going forward. He pointed out that Alaska would be the only state to put the specificity proposed by the governor into its constitution.

Representative Edgmon stressed that Alaska would be the only state with 50/50 sideboards in its constitution into time immemorial. He remarked that Mr. Steininger and Commissioner Mahoney had not been able to provide a response other than it was a value issue. He did not understand how the administration had made the determination given it had not been out talking to the people. He stated it was the position of the administration to do a 50/50 split because it produced a higher PFD. He underscored that it would also produce higher taxes, bigger cuts, and numerous unknowns that a 10-year plan could not begin to predict. He stated that the nature of things in Alaska were bigger, more expensive, and more volatile than in any other state. He would continue to struggle with the issue. He thanked the presenters.

Commissioner Mahoney reported that DOR was currently working on updating a presentation it had done with Commonwealth North the previous summer that identified all of the different revenue types, the impact to changing some of the taxes, as well as new revenues associated with income and sales taxes. The department's goal was to update the presentation with 2021 numbers prior to mid-July because DOR planned to present it to the [House] Ways and Means Committee.

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Representative Josephson referenced a 10-year plan from FY 11 that appeared to be at the transition between the resignation of Governor Sarah Palin and Governor Sean Parnell. He stated that at the time, under a conservative administration, OMB believed there would responsibly be 3 percent annual budget growth. He elaborated that OMB had

projected ANS West Coast oil prices of \$104 per barrel in FY 20 and it had projected the CBR would grow to almost \$24 billion. He stated that none of the projections had come to fruition. He thought it illustrated that a number of legislators believed what they had been told by conservative financial experts who subscribed to the 5 percent formula going forward. He detailed that some had been concerned a 5 percent draw was too liberal. He expressed concern over the governor's \$3 billion bridge fund proposal and asked why the present was any more special than five years in the future. He wondered whether there would be another bridge fund in five years. He believed the administration was really asking the legislature to throw out SB 26. Additionally, the administration was asking the legislature to take \$1.5 billion off the table in perpetuity for future legislatures that would have different and varying concerns that were currently impossible to imagine. He asked for comment from the administration.

Mr. Steininger replied that the proposed \$3 billion bridge fund draw from the ERA to the CBR was a one-time event. He disputed the statement that the draw would throw away the provisions under SB 26 given the governor's current proposal to enshrine the bill provisions in the constitution. He stated that in five years when the \$3 billion draw would have been drawn down, there would not be an option to go back to the ERA to draw more. He stressed the proposal was a one-time event to allow the state time to enable the constitutional amendment to take place and get through the period containing a significant difference between revenues and expenditures. He did not necessarily share Representative Josephson's concern that the administration was proposing to repeat the policy in the future. He stated that the proposal was a one-time mechanism to allow the state to get to a more sustainable fiscal picture.

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Representative Wool referenced the 10-year plan from 2011 cited by Representative Josephson and asked what the production level projections had been. He guessed the projection had not been (the current rate of) under 500,000 barrels. He noted the Permanent Fund was currently at a high based on recent stock market activity. He remarked that many of the gains made by the Permanent Fund were

unrealized because the stocks had not yet been sold. He asked if the administration was making any market correction projections going forward. If not, he wondered why. He thought the projections may be overly optimistic as they had been in the projections 10 years back.

Commissioner Mahoney answered that DOR had done a significant amount of stress testing on the model. One area of focus had been on how investment returns would impact the POMV and its ability to meet the governor's goals of a 50/50 plan. She elaborated that a PowerPoint had been developed, which she was happy to share with the committee. The department had identified different periods of investment returns in 10-year increments. She relayed the model identified whether the additional \$300 million in revenue would be sufficient to withstand any market corrections.

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^PRESENTATION: ANALYSIS OF GOVERNOR'S FISCAL PLAN BY
LEGISLATIVE FINANCE DIVISION

ALEXEI PAINTER, DIRECTOR, LEGISLATIVE FINANCE DIVISION, presented a PowerPoint titled "Analysis of Governor's Fiscal Plan," dated June 8, 2021 (copy on file). He began on slide 2 with the Legislative Finance Division (LFD) baselines prior to speaking to the governor's plan. He detailed that LFD had presented two budget baselines in its overview of the governor's budget in January, including current law and current policy. He explained that the baselines were designed to provide a neutral starting point for the year's budget discussions, separate from any policy choices made in the governor's budget request. He stated that LFD's fiscal modeling was currently based on versions of the FY 22 budget that were similar to those baselines. He reported that LFD's fiscal model was designed to show policy makers the longer-term impact of fiscal policy decisions. He explained that LFD's baseline assumed current budget levels were maintained (adjusted for inflation into the future). He noted that any policy differences were highlighted against the baseline.

Mr. Painter provided LFD revenue assumptions on slide 3. He detailed that LFD's baseline revenue assumptions used DOR's spring revenue forecast for petroleum and non-petroleum revenue. The forecast assumed oil prices of \$61 per barrel, growing with inflation in future years. The assumptions also included the Department of Natural Resources (DNR) forecast showing an increase in oil production from 459,700 barrels per day in FY 22 to 565,500 barrels per day in FY 30. Additionally, LFD's baseline assumed actual FY 21 returns for the Permanent Fund through the April 30 Alaska Permanent Fund Corporation (APFC) statement and Callan's 6.2 percent assumption for FY 22 and beyond.

Mr. Painter reviewed LFD's spending assumptions on slide 4. He detailed that for agency operations, LFD was using the Senate's first committee substitute, growing with inflation. He noted the number reflected an ~\$8 million difference from the original baseline. He explained that the specific bill version was used as a reasonable starting point because it did not include any one-time fund sources that were present in other versions of the budget. He noted that the number was very close to the current law and current policy baseline and the adjusted base (the previous year's budget without one-time items).

Mr. Painter continued to review spending assumptions on slide 4. For statewide items, LFD's baseline assumed that all items were funded to their statutory levels. Statewide items included school debt reimbursement, the Regional Educational Attendance Area (REAA) fund, community assistance, oil and gas tax credits, and the PFD. He noted that LFD's baselines represented the current law scenario, and its fiscal modeling generally assumed the legislature was following statutes, unless told otherwise. The assumptions also included a baseline for fund transfers, which was essentially the ongoing cost of DEC's Spill Prevention and Response program.

Mr. Painter reviewed capital budget spending assumptions on slide 4. He explained that LFD's assumption for the capital budget used the Senate's first committee substitute of \$176.7 million undesignated general funds (UGF) growing with inflation of 2 percent. The number represented the governor's original capital budget submission as of the February amendment deadline without any one-time fund sources. He detailed the governor's submittal had included use of Power Cost Equalization (PCE) funds that were not

statutorily designated and use of Alaska Housing Finance Corporation (AHFC) bonding. He elaborated that the Senate's first committee substitute had reversed the one-time funding sources and reflected a pretty clean start for the year. In comparison, the governor had submitted additional amendments during session; therefore, his capital budget request was significantly higher. He addressed LFD's spending assumptions of \$50 million per year for supplementals. The amount was based on the average supplemental appropriations in the past five years minus any lapsing funds. He clarified the amount reflected the difference between the budget passed in session and actual spending.

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Co-Chair Merrick noted the slide assumed statewide items including the PFD would be funded at the statutory level. She asked for the specific amount used for the PFD.

Mr. Painter answered that for the models of the governor's plan, LFD assumed the change to the 50/50 PFD. For any other models, LFD would use the requestor's amount.

Mr. Painter turned to slide 5 and compared the governor's 10-year plan to LFD baselines. He discussed that the governor's 10-year plan for the budget made several policy choices aimed at reducing spending. The governor's plan included 50 percent funding of school debt reimbursement and REAA fund capitalization. The governor's FY 22 budget was \$65.7 million less for agency operations than the Senate's first committee substitute. He detailed that some of the difference was due to one-time items, but the governor's 10-year plan backed the items out for subsequent years; therefore, the difference was not large. The governor's plan included \$100 million in additional reductions in FY 23 and FY 24. Additionally, the governor's plan used agency growth of 1.5 percent rather than with inflation. He reported that the governor's plan assumed supplementals and lapse were balanced out.

Mr. Painter referenced a document in members' packets titled "OMB and LFD Fiscal Model Assumption Comparison" (copy on file), which showed all of the administration's policy choices. He highlighted two points where there were differences in baselines. He pointed to the POMV draw on the second line and explained that LFD assumed returns of

6.2 percent as presented by Callan, while OMB's assumptions included a 6.25 percent return. The second difference pertained to retirement. He explained that the Alaska Retirement Management Board (ARMB) was responsible for setting rates and was meeting the following week. He detailed that ARMB would adopt numbers with FY 20 actual investment results. He elaborated that the FY 22 cost in the budget was based on FY 19 because it was the number most recently adopted when the budget was prepared. He expounded that the numbers OMB used in its 10-year plan reflected the official ARMB numbers prior to its action set to take place in the coming week. He elucidated that LFD did not have to use official numbers because its analysis was not a legally required document; therefore, it used draft numbers prepared in December that ARMB would adopt in the coming week. He noted the difference was relatively minor. He stated that the level of budget reductions [in the governor's 10-year plan] were not necessarily unattainable, but the governor's scenario reflected significant policy choices and not a baseline.

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Mr. Painter advanced to a table on slide 6 showing a comparison of the governor's 10-year plan to LFD baselines. He noted the negative numbers reflected areas where the governor's plan was below the LFD baseline. He detailed that in FY 22, the governor's plan was \$128.8 million below LFD's baseline. The difference grew over the coming two years with the [two years of] \$100 million cuts and without the 2 percent growth. He elaborated that the impact on the baseline was bigger than \$100 million in cuts because it meant cutting below inflation. He furthered that the gulf widened a bit in the future due to the different inflation numbers. He pointed out that the biggest policy choice was in agency operations where the governor's assumption was \$3.1 million below the baseline of the current year budget growing with inflation. The statewide items reflected the school debt and REAA funding at 50 percent and the retirement difference. The capital budget was the difference between the governor's amended budget from February and the \$150 million baseline for future years. The LFD and OMB assumptions for fund transfers were aligned and there was a difference in supplementals. He summarized that the bulk of the difference came from agency operations and a smaller portion from statewide. The graph on the bottom of the slide illustrated that LFD's baseline grew

with inflation, while the governor's baseline was relatively flat.

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Mr. Painter moved to slide 7 titled "Analysis of Governor's Comprehensive Fiscal Plan." He highlighted that OMB's 10-year plan had \$4.86 billion less spending during FY 22 through FY 30. The current legislative policy level reflected in the LFD baseline included full funding for statewide items. The LFD analysis added \$300 million in new revenue or additional budget reductions beginning midway through FY 24 (half of the amount would occur in FY 24 and the full \$300 million beyond that time). The governor's plan would constitutionalize the PFD at 50 percent of the POMV, which equated to ~\$2,350 per recipient in FY 22. The governor's plan would transfer the PCE Fund to the Permanent Fund and constitutionally mandated some funding for power cost equalization. Additionally, the governor's plan included a one-time \$3 billion transfer from the ERA to the CBR to act as bridge funding.

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Representative Edgmon asked if in any of the discussions about transferring the PCE Fund to the Permanent Fund had acknowledged the tension between the legislature's constitutional power to appropriate versus language that would specify some funding for power cost equalization. He wondered whether the subject had come up during LFD's internal analysis.

Mr. Painter noted that he is not an attorney and could not speak to the legal aspect. He relayed there had been discussion on the topic during a House Judiciary Committee meeting the previous week with the administration's attorneys. He presumed that Legislative Legal Services had opinions on the topic, but he had not heard them.

Mr. Painter moved to slide 8 and continued an analysis of the governor's proposed fiscal plan. He stated that LFD's modeling and the governor's modeling did not have significant differences. He noted that the numbers presented by the administration were technically sound. The question for the legislature was whether it agreed with the policy choices in the governor's plan. He explained that the legislature currently had four main levers to use to

balance the budget, including drawing from savings accounts (including the ERA), reducing the PFD, reducing the budget, or increasing revenue. He highlighted that the governor's plan removed the first two options. Under the governor's plan, the legislature could no longer reduce the PFD or draw from savings accounts because the ERA was essentially the only remaining source (the CBR only contained about \$1 billion). He detailed that over the past nine years of deficits, three of the four levers had been used including budget reductions, PFD reductions, and savings draws. The state was currently essentially out of savings beyond the ERA. He explained that the governor's plan would require additional budget reductions or new revenue if existing revenue sources did not meet DOR's projections.

Mr. Painter continued to review slide 8. He stated that the administration's proposed \$3 billion "bridge" allowed time for increases to existing revenue sources. He noted that strong Permanent Fund gains in the current year would feed into the POMV over the coming five years (due to the five-year average), which would increase state revenue. There were also some short-term effects caused by the pandemic in the corporate income tax that the state expected to see rebound. He noted in the next several years in the revenue forecast, revenue grew significantly faster than inflation. He stated that the proposed \$3 billion bridge "perhaps is a bridge to that." Additionally, the funding was a bridge to the \$300 million in new revenue (or additional cuts) and the \$200 million spending reductions built in to balance the budget. He explained that without the bridge funding, there was not sufficient funding in the CBR to transition to the new system, while also paying a 50/50 PFD over the coming two years. He stated it was not possible to pay the 50/50 PFD over the next few years without some sort of overdraft unless new revenues phased in much faster than the governor's plan.

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Representative Josephson highlighted concerns he had raised to Mr. Steininger regarding SJR 6 and HJR 7 earlier in the meeting. He had shared his concern of the possibility of duplicating the bridge fund. He believed Mr. Steininger had stated that the bridge fund could not be duplicated under the proposal because the ERA would be folded into the corpus of the Permanent Fund. He considered the order of operations. He stated that the situation would be back to

ground zero if the legislature agreed to overdraw and move \$3 billion into the CBR but failed to deliver a supermajority on the overall plan. He thought they could come to a point where someone stated they were at the next bridge in the future.

Mr. Painter stated his understanding of the question and agreed the scenario was possible. He believed that the order of operations was important because there would continue to be a deficit if some but not all elements of a plan were adopted. He stated that the plan worked if all of the elements were adopted; however, if a higher PFD was adopted, but new revenue and budget cuts were not implemented, the \$3 billion bridge would not last long. He agreed that the \$3 billion was only sufficient if the other steps were taken in the meantime.

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Mr. Painter moved to slide 9 and discussed that evaluating a fiscal plan required goals and metrics. He explained that the plan could not be merely evaluated as a policy document without having some goal. He detailed that LFD could imagine the legislature may have a wide variety of goals or metrics to fulfill in designing a fiscal plan. He stated that without explicit information it was difficult to identify whether the governor's proposed plan worked or fulfilled the legislature's goals. He provided some examples of how goals could change the evaluation of a plan. He stated that if the goal was to balance the budget at current oil prices, perhaps the governor's plan that proposed to balance the budget in the next several years was sufficient with the current oil forecast. Another argument would be that current oil prices were high enough in the \$61 per barrel range that the state should be trying to generate surpluses to rebuild the CBR to account for times of lower oil prices in the future. He noted with that goal in mind, a plan would need to either generate more revenue or reduce the budget.

Mr. Painter continued to address slide 9. He stated that another difference in opinion would be whether it was more important to avoid broad-based taxes and taxes to industries or to have distributional equity where the impact of reduced PFDs and impact of dividends were equal across the income bracket. He remarked that the two options were opposing ideas where fundamentally it would not be

possible to come to the same evaluation of a plan if there was disagreement about the relative importance of the two ideas. Another topic addressed by the committee was whether it was important to maintain downward pressure on spending or if cuts had already gone too far. He stated that the governor's plan fundamentally sided with the idea that further downward pressure on spending was needed. He noted that some of what had been said during the current committee discussion was there may be needs beyond the governor's proposed plan. He clarified that the two ideas were not compatible within the same fiscal plan because the goals were fundamentally different.

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Mr. Painter concluded his analysis of the governor's fiscal plan on slide 10. He remarked that it was difficult to provide analysis from a nonpartisan standpoint because of the differences in the goals and metrics for success. He provided questions for the committee to consider [shown on the slide]:

- Which elements of a plan should be constitutional, and which should be statutory?
- If the Legislature does not agree with the Governor's spending reduction plan, should the difference be made up with more revenue or with lower PFDs?
 - This question could be flipped around in any direction.
- If (when?) oil revenue declines substantially in the future, will this system still be sustainable?
- Would voters approve this constitutional amendment (HJR 7, Permanent Fund)? What about HJR 6 (spending limit) and HJR 8 (voter approval of taxes)? Are all necessary for the Governor's plan to work?

Mr. Painter elaborated on the above questions beginning with the first bullet point. He asked whether the POMV draw should be in the constitution or in statute. He asked whether some level of dividend and a formula needed to be in the constitution or in statute. He asked whether the PCE Fund should be moved into the Permanent Fund, dealt with in the constitution, or left in statute. He moved to the second bullet point. He stated that the question could be flipped in any number of ways. For example, if a legislator did not believe the \$300 million of new revenue was realistic, it was appropriate to ask whether it should be

made up with lower PFDs or lower spending. He stated the different scenarios brought tradeoffs for each of the pieces involved in balancing the budget. He advanced to the third bullet point. He asked about the sustainability of the system the governor proposed to constitutionalize. He asked whether the plan would only be sustainable at the current forecast. He stated that to some degree anything could be sustainable if the state taxed enough. He questioned whether it was desirable or not. He asked whether the proposed dividend level would be workable if oil prices and oil revenue declined in the future. He concluded with the fourth bullet point. He asked whether all components of the governor's proposal were necessary and whether the plan fall apart if one of the proposals passed and the others did not. He believed the question needed further scrutiny.

Co-Chair Merrick thanked the presenters. She remarked that there was a long road ahead.

#

ADJOURNMENT

[3:32:59 PM](#)

The meeting was adjourned at 3:32 p.m.